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IN THE

Supreme Court of the United States

October Term, 1944.

No. 128.

H. LEWIS BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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General.

Respondent's brief is conspicuous for its omission of two basic elements. It fails to state what the problem before the Court was and it does not even allude to the fact that the Tax Court found itself unable to solve the problem, except on a purely arbitrary or theoretical basis (R. 57, 58).

The problem, as understood by the Tax Court, involved "an allocation thereof [the fee in question] between the period of joint interest and the period thereafter" (R. 48). A similar conception on the part of the Court below was that a resolution of the issue "required a valuation of that part of the fee which in 1937 . . . belonged to the Burroughs estate", and that "since all the pertinent facts needed for that purpose were fully available in 1937, no occasion existed for postponing that valuation until a later year"

(R. 149); *in other words, the problem was to value petitioner's interest on the basis of the pertinent facts, all of which occurred during 1937.*

Both courts below were aware of the necessity of placing a valuation on petitioner's interest in the fee when received. The Court below stated that "the sole issue here is whether the Tax Court erroneously determined the 1937 value of the estate's claim" (R. 150).

All pertinent evidence was adduced. The Tax Court held that from this pertinent evidence it could do no more than "to make some kind of a theoretical allocation" in the premises (R. 57, 58), and hence resorted to a settlement of a later year, not as a valuation, but, with considerable apology, as a judge-made substitute for a valuation.

These basic elements are absent from Commissioner's brief and argument.

Reasons for Granting the Writ.

On this point it is urged that petitioner has shown no reason for granting the writ, particularly on the angle of conflict. Petitioner cited *Taylor* v. *Commissioner,* 70 F. (2d), 619 at 621, where Judge Learned Hand fully develops the fact that there is conflict on this matter and to a similar discussion of that subject by this Court in the same case (293 U. S. 507, 79 L. Ed. 623). The conflict extends even to what is required to upset the presumption, which is the foundation stone on which the Commissioner rests. Some Courts hold that when evidence is produced "as to the process by which the commissioner arrived at his determination" and this process is illegal, as is obviously true here, "the presumption ceased, and thenceforth the issue depended 'wholly upon the evidence'." (*True* v. *U. S.,* 51 F. Supp. 720 at 725, citing among other cases *Hemphill*

Schools v. *Commissioner,* 137 F. (2d) 961. See also *New York Life* v. *Gamer,* 303 U. S. 161, 82 L. Ed. 726.)

In the instant case the Court below held that the Tax Court's figure, based on a compromise settlement made in a post tax year, was a "valuation" and that, therefore, the Court "need not consider whether the Tax Court, in arriving at its conclusion, properly relied upon the settlement made in 1938" (R. 150). That view is directly in conflict with a decision of the Sixth Circuit handed down April 12, 1944 (*Cornett-Lewis Coal Co.* v. *Commissioner,* 141 F. (2d) 1001), where it was held that the Commissioner's determination must be "from some competent evidence", that "the imposition of a tax cannot rest purely on a statutory presumption if such presumption is inconsistent with the facts", and that when "such [contrary] evidence appears the presumption ends" (1004). The Circuit Court of Appeals for the Sixth Circuit also in that case openly disapproved the views of the Second Circuit on this issue as reflected in *Regensburg* v. *Helvering,* 130 F. (2d) 507, and ruled that before the Commissioner may assess a deficiency, he "must find facts supporting the assessment" and that the "taxpayer is entitled to know the basis of law and facts" on which the assessment is made and "until this is done, there is no burden of proof resting on the taxpayer".

The Court below certainly put the cart before the horse in saying that it was unnecessary to consider the legality of the basis.

It is suggested that not only must illegality of basis be shown but error in amount as well. Respondent asserts over and over again that the result is right because it reflects the amount of petitioner's share in the fee to the exact penny, not the 1937 value of his interest, but the amount for which it was liquidated in 1938. That assertion assumes

that the problem was to find out what petitioner ultimately realized. The Tax Court and the Court below, as the statute obliged them to do, conceived the problem to be to ascertain the 1937 value of petitioner's interest, that is, what was the value in 1937 of petitioner's interest in the fund of $106,051 then in his hands. The answer to that question required a weighing of the evidence, that is, all of the evidence bearing on that point in 1937 (*Ray Consolidated* v. *U. S.*, 268 U. S. 373; *N. Y. Life* v. *Gamer*, 303 U. S. 161).

The Tax Court having reached the conclusion on the evidence that it could not find the answer otherwise than on a purely theoretical basis, we believe that the principle of the *Dobson* case requires a holding that the Commissioner failed to carry the burden of proof. Petitioner ultimately received approximately $99,000 in April 1938 out of the fund of $106,051, and the Commissioner assessed him on that basis as if that was the value in 1937. What does value as of a given date mean? Does it mean the ultimate realization as of some later known date? Or does it mean what could be realized on a liquidation of the item as of the time in question? Certainly it does not mean the former. Conceivably it might well mean the latter (*Cf. Andrews* v. *Commissioner*, 135 F. (2d) 314, certiorari denied). If it means the latter, that is, realizable value in 1937, then no one will suggest that petitioner could have realized anywhere near $99,000 on his interest in that claim at any time in 1937. The estate had not fixed a dollar value on its interest but had insistently urged that it was entitled to participate on the basis of a ten-year period of joint interest. That view, if sustained, would have meant that petitioner's interest was worth not $99,000, but something less than $60,000. The taxpayer does not have to measure the depressing effect in dollars of the estate's position, but if considerations of that character apparent in the record

show the assessment is too high, the appellate court will be governed accordingly and will not require the taxpayer to show the correct figure (*Taylor* v. *Commissioner*, 70 F. (2d) 619, 293 U. S. 507).

Respondent denies that the question involved is one of general interest or of broad application in the administration of the tax laws. Of course, it is of great interest to the Commissioner that the decision should stand, for it gives him an unconscionable advantage over the taxpayer in all similar situations. By it he is allowed through retrospect to hold the taxpayer to the duty of doing the impossible, viz., to report the future. But the Commissioner is not the sole party in interest and an honest taxpayer is entitled to honest treatment just as much as an honest Commissioner. The consideration of public interest extends to the taxpayer as well as to his servant the Government.

On the same issue of reasons for the writ nothing is said about the fact that the point on which the case was decided, namely, burden of proof, was never once raised in the Tax Court or in the court below by either party, in oral or written argument, but was an issue created by the decision of the court below, which denied the opportunity for argument that a rehearing would have afforded. Inevitably the taxpayer thus treated feels the sting of a sense of injustice and it is an important function of the courts to avoid the creation of such a feeling, if reasonably founded.

Much is said of circumstances such as that petitioner had control of the fund, that he didn't expect to pay the estate one-half of the fee, and similar circumstances. But all these are beside the point. They could have relevancy only as to whether or not the fund was received under a claim of right and only for that purpose. But both courts below held that claim of right was not an element in the case. The Court of Appeals said, "As the entire fee did not

belong to Brown, and as he does not claim all of it, it cannot in its entirety be included in his taxable income for any year" (149). Hence reiteration of these and similar irrelevant circumstances is not consistent with sound briefing. The real problem was not to determine whether petitioner controlled the fund or whether the estate's interest was half of the fund but to determine solely the value in dollars of petitioner's interest in the fund and to make that determination solely in the light of the facts as they existed in 1937.

It is even said that the taxpayer confuses valuation of an interest as distinguished from the determination of the amount of taxable income received in a given year. True, the ultimate problem is to determine the amount of the taxable income received in a given year, but, to attain that goal it is first necessary to value taxpayer's interest in the fund *and to value it as of 1937*.

If the compensation had been in the form of shares of stock having a market value, then, of course, petitioner would have been taxable on that market value as of the time of receipt. If the stock had not possessed a market value then it would have been necessary to ascertain the value of the stock under well established principles of valuation in such situations and petitioner would have been taxable accordingly. If he had sold the stock in April, 1938, at a figure above or below the 1937 valuation that would have had no relevancy on his 1937 return. The gain or loss would have to be reflected in his 1938 return.

If the compensation had been in the form of an unliquidated demand against a third party, then petitioner would have been taxable on the value of that demand at the time of its assignment to him, that is, if the facts were such as to make the demand reasonably susceptible of valuation. If there was no way to place a reasonable

valuation on this demand as of the date of assignment then taxation would have to be deferred until the transaction was closed by liquidation or otherwise. The present case is in exactly the same category. Petitioner's compensation was in the form of a claim or demand against a fund in his hands. If that claim was susceptible of valuation he was taxable in 1937 accordingly. If, as the Tax Court held, it was not susceptible of more than a theoretical or arbitrary valuation in 1937, then taxation must be postponed and the Tax Court's decision to that effect is binding on appeal (*Dobson*).

Controversies ought to be settled on their merits. That is true of all controversies. It is particularly true in this case where every fact relating to merits was before the Court. This Court has well said that

> "Courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved * * * as the justice of the case may require."
>
> *Chicago, Milwaukee & St. Paul R. Co.* v. *Minneapolis Civic Ass'n*, 247 U. S. 490, 501.

The federal courts have repeatedly, after quoting the above language, said that the rule "is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer." (*Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695; *Early* v. *Southgate*, 136 F. (2d) 217 at 221; *True* v. *U. S.*, 51 Fed. Supp. 720, 725).

The principle announced is peculiarly applicable to the present situation. There is no suggestion on the record that petitioner has sought to evade or avoid any tax nor avail of any technicalities whatsoever and in such a situation it is highly inappropriate that technicalities should be invoked by the Government to work unreasonable and unnecessary hardship on the taxpayer.

Petitioner is entitled to have his case heard on the merits and decision reached on legal evidence.

Respectfully submitted,

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July 7, 1944.